



# **TABLE OF CONTENTS**

	<b>Page</b>
TABLE OF EXHIBITS .....	iii
A. COUNSEL FOR THE PARTIES .....	1
Plaintiff .....	1
Defendant .....	2
B. STATEMENT OF JURISDICTION.....	3
C. NATURE OF ACTION .....	3
D. CONTENTIONS OF THE PARTIES .....	3
Plaintiff's Contentions .....	3
Defendant's Contentions.....	4
E. STIPULATIONS AND UNCONTESTED FACTS .....	6
F. CONTESTED ISSUES OF FACT AND LAW .....	6
Plaintiff's Contested Issues.....	6
Defendant's Contested Issues .....	7
Defendant's Issues of Fact .....	7
Defendant's Issues of Law .....	10
G. LIST OF WITNESSES .....	11
Plaintiff .....	11
Defendant .....	11
A. Witnesses Who Will Be Called To Testify At Trial .....	11
B. Witnesses Who May Be Called To Testify At Trial.....	12
C. Witnesses Who May Be Presented By Deposition Testimony At Trial.....	12
H. LIST OF EXHIBITS.....	12
I. JURY INSTRUCTIONS.....	13
J. LIST OF ANY PENDING MOTIONS.....	13
Plaintiff's Motions .....	13

	Defendant's Motions.....	13
K.	PROBABLE LENGTH OF TRIAL.....	13
L.	MANAGEMENT CONFERENCE LIMITATIONS.....	13
M.	CERTIFICATIONS .....	14

**TABLE OF EXHIBITS**

<b>EXHIBIT</b>	<b>DESCRIPTION</b>
Exhibit A	PalTalk's Witness List
Exhibit B	PalTalk's Deposition Designations
Exhibit C	Microsoft's Deposition Designations
Exhibit D	PalTalk's Exhibit List
Exhibit E	Microsoft's Exhibit List
Exhibit F	PalTalk's Proposed Preliminary Jury Instructions
Exhibit G	PalTalk's Proposed Post-Trial Jury Instructions
Exhibit H	PalTalk's Proposed Verdict Form
Exhibit I	Microsoft's Proposed Preliminary and Final Jury Instructions
Exhibit J	Microsoft's Proposed Verdict Form

This case came before the Court at an initial pre-trial conference held on February 12, 2009 and a final pre-trial conference held on March 5, 2009 pursuant to Local Rule CV-16 and Rule 16 of the Federal Rules of Civil Procedure.

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**B. STATEMENT OF JURISDICTION**

This Court has subject matter jurisdiction pursuant to 28 U.S.C. §§ 1331 and 1338(a) because this action arises under the patent laws of the United States, including 35 U.S.C. § 271 et seq. This Court has personal jurisdiction over all the Parties.

Venue is proper in the United States District Court for the Eastern District of Texas, Marshall Division.

**C. NATURE OF ACTION**

This is an action for infringement of Plaintiff PalTalk's patents wherein PalTalk will seek to prove that Defendant Microsoft infringed eight asserted claims of United States Patent Nos. 5,822,523 (the '523 patent) and 6,226,686 (the '686 patent). PalTalk will also seek to demonstrate that Microsoft's infringement was and is willful and that this is an exceptional case. PalTalk seeks damages to compensate for Microsoft's infringement, in an amount no less than a reasonable royalty; as well as, attorneys' fees, costs and enhancement of damages.

**D. CONTENTIONS OF THE PARTIES**

Plaintiff's Contentions:

1. PalTalk contends that Microsoft infringes one or more claims of the '523 patent and '686 patent.
2. PalTalk contends that Microsoft's infringement is and has been willful.
3. PalTalk contends that the '523 patent and '686 patent are presumed valid, and that Microsoft has failed to prove invalidity by clear and convincing evidence.
4. PalTalk contends that Microsoft received actual and constructive notice of PalTalk's patents, prior to the filing of this lawsuit, and thereafter infringed PalTalk's patents. PalTalk further contends that Microsoft "recklessly disregarded the possibility" that it was infringing PalTalk's patents. PalTalk seeks enhanced damages for willful infringement.

5. PalTalk contends that it is entitled to damages adequate to compensate for Microsoft's infringement, in an amount no less than a reasonable royalty for the use made of the invention by Microsoft.
6. PalTalk contends that, unless enjoined, Microsoft will continue to infringe '523 patent and '686 patent, and an injunction to prevent Microsoft's continued infringement is warranted.
7. PalTalk contends that this is an exceptional case entitling PalTalk to attorneys' fees.

Defendant's Contentions:

Microsoft contends that no authorized use of Xbox (original and 360) consoles, asserted games, and the Xbox Live Service practice the methods claimed in the asserted claims. Plaintiff cannot meet its burden of proving that an accused combination literally practices each and every step of any of the asserted claims. And Microsoft does not induce or contribute to any alleged infringement performed by players.

Microsoft contends that claims 1 and 6 of the '523 patent and claims 1, 3, 5, 12, 14, and 18 of the '686 patent are invalid as anticipated by the prior art; invalid as obvious in light of the prior art; invalid as not adequately enabled; and invalid as lacking a sufficient written description of the claimed invention.

Microsoft contends that the resulting operation of the system of the '523 and '686 patents with the combined features would have been predictable and expected to one of ordinary skill in the art in the early to mid 1990's. There is nothing surprising or innovative—much less unpredictable—about the resulting combination.

Microsoft contends that several patents, publications, public uses, and inventions of the mid-1990s rendered the claims of the '523 and '686 patents obvious. Microsoft further contends that the level of skill was high and that a person of skill in the art would have had a broad and



deep understanding of network and packet design.

Microsoft contends that two early computer games—Netrek and TinyMUD—anticipate the asserted claims. Netrek is a prior art multi-player computer game, played over the Internet, that practices each limitation of every asserted claim except claim 5 of the '686 patent. As a result, Netrek invalidates every asserted claim except claim 5. TinyMUD is a prior art multi-player computer game, played over the Internet, that practices each limitation of claim 5 of the '686 patent. TinyMUD invalidates claim 5 of the '686 patent. Together, these references practiced every asserted claim more than one year prior to the filing date of the patents. Not only were these games widely played before more than one year before the filing dates, but the source code, describing the functionality of each game, was publicly available and widely distributed more than one year before the filing dates. The availability of these games and their source code render each asserted claim anticipated and obvious.

Microsoft contends that Plaintiff's claim for injunctive relief from the alleged infringement is barred because Plaintiff neither manufactures nor sells any product using the inventions disclosed in the asserted patents. Further, the accused functionality constitutes an insignificant portion of the overall technology used. As such, equity does not support Plaintiff's claim for injunctive relief.

Even if Plaintiff could show that Microsoft committed infringement, Plaintiff cannot show that Microsoft's infringement was willful. Regardless of any actions taken by those playing the games, Microsoft respects the intellectual property of others and never intended anyone to infringe any patents. In fact, Microsoft first learned that the asserted patents existed only after Plaintiff filed this lawsuit against Microsoft. And even then, after filing this lawsuit, Plaintiff did not seek a preliminary injunction to enjoin the sales of the Xbox console, paid Xbox Live subscriptions, or the asserted games. In any event, the defenses raised by Microsoft in this

suit are not frivolous. Plaintiffs cannot meet its burden to show that it is highly probable Microsoft acted objectively reckless toward the possibility of infringement.<sup>1</sup>

Microsoft contends that if damages are awarded, a reasonable royalty should be no more than a lump sum amount of \$600,000.

Lastly, Microsoft has asked for and should be granted a declaratory judgment that it does not infringe any claims of the asserted patents and that the asserted claims of the patents are invalid under Title 35, United States Code.

**E. STIPULATIONS AND UNCONTESTED FACTS**

1. United States Patent 5,822,523 (the '523 patent), entitled "Server-Group Messaging System for Interactive Applications" was issued by the United States Patent and Trademark Office on Oct. 13, 1998.
2. The application which issued as the '523 patent was filed on Feb. 1, 1996.
3. United States Patent 6,226,686 (the '686 patent), entitled "Server-Group Messaging System for Interactive Applications" was issued by the United States Patent and Trademark Office on May 1, 2001.
4. The application which issued as the '686 patent was filed on September 28, 1999 as a continuation of the '523 patent application and thus is entitled to an effective filing date of February 1, 1996.
5. Plaintiff PalTalk Holdings, Inc. is a Delaware company with its principal place of business at 120 Broadway, 34th Floor, New York, NY 10271-0002.

**F. CONTESTED ISSUES OF FACT AND LAW**

Plaintiff's Contested Issues:

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<sup>1</sup> This paragraph is only necessary if the Court denies Microsoft's pending motion for partial summary judgment on willfulness (Dkt. No. 121).

1. Whether Microsoft infringes the '523 and '686 patents.
2. Whether the '523 and '686 patents are invalid.
3. Whether Microsoft's infringement was willful, thus entitling PalTalk to enhanced damages.
4. Whether PalTalk is entitled to damages to compensate for Microsoft's alleged infringement and if so the amount of such damages.
5. Whether PalTalk is entitled to an injunction should Microsoft be found to have infringed PalTalk's patents.

Defendant's Contested Issues:

Defendant's Issues of Fact

1. Whether claim 1 of the '523 patent is invalid under 35 U.S.C. § 102 as anticipated?
2. Whether claim 1 of the '523 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
3. Whether claim 1 of the '523 patent is invalid under 35 U.S.C. § 112 as lacking adequate written description?
4. Whether claim 1 of the '523 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
5. Whether claim 6 of the '523 patent is invalid under 35 U.S.C. § 102 as anticipated?
6. Whether claim 6 of the '523 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
7. Whether claim 6 of the '523 patent is invalid under 35 U.S.C. § 112 as lacking adequate written description?
8. Whether claim 6 of the '523 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
9. Whether claim 1 of the '686 patent is invalid under 35 U.S.C. § 102 as anticipated?

10. Whether claim 1 of the '686 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
11. Whether claim 1 of the '686 patent is invalid under 35 U.S.C. § 112 as lacking adequate written description?
12. Whether claim 1 of the '686 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
13. Whether claim 3 of the '686 patent is invalid under 35 U.S.C. § 102 as anticipated?
14. Whether claim 3 of the '686 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
15. Whether claim 3 of the '686 patent is invalid under 35 U.S.C. § 112 as lacking adequate written description?
16. Whether claim 3 of the '686 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
17. Whether claim 5 of the '686 patent is invalid under 35 U.S.C. § 102 as anticipated?
18. Whether claim 5 of the '686 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
19. Whether claim 5 of the '686 patent is invalid under 35 U.S.C. § 112 as lacking adequate written description?
20. Whether claim 5 of the '686 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
21. Whether claim 12 of the '686 patent is invalid under 35 U.S.C. § 102 as anticipated?
22. Whether claim 12 of the '686 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?

23. Whether claim 12 of the '686 patent is invalid under 35 U.S.C. § 112 as lacking adequate written description?
24. Whether claim 12 of the '686 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
25. Whether claim 14 of the '686 patent is invalid under 35 U.S.C. § 102 as anticipated?
26. Whether claim 14 of the '686 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
27. Whether claim 14 of the '686 patent is invalid under 35 U.S.C. § 112 as lacking adequate written description?
28. Whether claim 14 of the '686 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
29. Whether claim 18 of the '686 patent is invalid under 35 U.S.C. § 102 as anticipated?
30. Whether claim 18 of the '686 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
31. Whether claim 18 of the '686 patent is invalid under 35 U.S.C. § 112 as lacking adequate written description?
32. Whether claim 18 of the '686 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
33. What was the level of ordinary skill in the art as of February 1, 1995?
34. Whether individual users, who are not Microsoft employees, directly infringed any valid, asserted claim?
35. Whether Microsoft knowingly induced any individuals to directly infringe any valid, asserted claim?

Defendant's Issues of Law

1. Whether claim 1 of the '523 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
2. Whether claim 1 of the '523 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
3. Whether claim 6 of the '523 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
4. Whether claim 6 of the '523 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
5. Whether claim 1 of the '686 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
6. Whether claim 1 of the '686 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
7. Whether claim 3 of the '686 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
8. Whether claim 3 of the '686 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
9. Whether claim 5 of the '686 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
10. Whether claim 5 of the '686 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
11. Whether claim 12 of the '686 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?

12. Whether claim 12 of the '686 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
13. Whether claim 14 of the '686 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
14. Whether claim 14 of the '686 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
15. Whether claim 18 of the '686 patent is invalid under 35 U.S.C. § 103 as obvious (legal conclusion with underlying factual findings)?
16. Whether claim 18 of the '686 patent is invalid under 35 U.S.C. § 112 as not enabled (legal conclusion with underlying factual findings)?
17. Whether this is an exceptional case?
18. Whether any actual damages awarded in this case should be enhanced?
19. Whether an injunction should be entered and the scope of such an injunction?
20. Whether attorney fees should be awarded to Microsoft in this case?

**G. LIST OF WITNESSES**

Plaintiff:

PalTalk's witness list is appended hereto as Exhibit A. For the Court's convenience, PalTalk's deposition designations are appended here to as Exhibit B .

Defendant:

**Microsoft case-in-chief**

**A. Witnesses Who Will Be Called To Testify At Trial**

1. John K. Bennett (expert witness)
2. Cate M. Elsten (expert witness)
3. Christopher Butcher
4. Tony Chen

5. Peter Isensee

6. Bill Nielsen

**B. Witnesses Who May Be Called To Testify At Trial**

1. William Harmon

2. Kipley Olson

3. Craig Henry

4. Chris Phillips

5. Jon Grande

6. Ed Fries

7. Jason Katz

8. Nicolas Gauvin

9. Any witness listed as a "will call" witness on Plaintiff's witness list

10. Any witness listed as a "may call" witness on Plaintiff's witness list

**C. Witnesses Who May Be Presented By Deposition Testimony At Trial**

1. James Aspnes

2. Andrew McFadden

3. Kevin Smith

4. Marc Kwiatkowski

5. Jeffrey Rothschild

For the Court's convenience, Microsoft's deposition designations are appended here to as Exhibit C. The parties will meet and confer regarding their respective objections to deposition designations.

**H. LIST OF EXHIBITS**

Plaintiff: PalTalk's exhibit list is appended hereto as Exhibit D.

Defendant: Microsoft's exhibit list is appended hereto as Exhibit E.

The parties will meet and confer regarding their respective objections to the submitted exhibits.



**I. JURY INSTRUCTIONS**

The parties have prepared proposed jury instructions and verdict forms, attached hereto as Exhibits F-H (PalTalk) and Exhibit I-J (Microsoft). The parties have conferred preliminarily regarding their respective instructions and will continue to do so in an effort to reach agreement on instructions, subsequent to the submission of this order.

**J. LIST OF ANY PENDING MOTIONS**

Plaintiff's Motions:

PalTalk's Motion to Compel Production of Licenses and Data (DKT #163)

Pre-trial Motions in Limine filed by PalTalk in connection with this Joint Pretrial Order.

Defendant's Motions:

Microsoft's Motion for Summary Judgment of Anticipation (DKT #113)

Microsoft's Motion for Partial Summary Judgment with Respect to Willfulness and Inducement (DKT #121)

Microsoft's Motion for Partial Summary with Respect to Non-Infringement (DKT #120)

Microsoft's Motion to Strike Expert Declaration of Dr. V. Thomas Rhyne (DKT #147)

Microsoft's Motion to Exclude the Proposed Damages Testimony of James J. Nawrocki (DKT #158)

Pre-trial Motions in Limine filed by Microsoft in connection with this Joint Pretrial Order.

**K. PROBABLE LENGTH OF TRIAL**

The parties estimate that trial should last 8-10 court days, including jury selection and instructions.

**L. MANAGEMENT CONFERENCE LIMITATIONS**

None.

**M. CERTIFICATIONS**

The undersigned counsel for each of the parties in this action do hereby certify and acknowledge the following:

- (2) Full and complete disclosure has been made in accordance with the Federal Rules of Civil Procedure and the Court's orders;
- (3) Discovery limitations set forth in the Federal Rules of Civil Procedure, the Local Rules, and the Court's orders have been complied with and not altered by agreement or otherwise;
- (4) Each exhibit in the List of Exhibits herein:
  - (a) is in existence;
  - (b) is numbered; and
  - (c) has been disclosed and shown to opposing counsel.

This Joint Pre-Trial Order is hereby approved.

DATED: February 2, 2009

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

I hereby certify that on February 2, 2009, I electronically filed the foregoing document in compliance with Local Rule CV-5a(3). It has been served this day on the counsel of record, who are deemed to have consented to electronic service via the Court's CM/ECF System. Any other counsel of record will be served by electronic email, facsimile transmission and/or First Class Mail on this same date.

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